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No. 08-1404

IN THE
Supreme Court of the United States

DEVON ENERGY CORPORATION,

Petitioner,

v.

KENNETH L. SALAZAR,
SECRETARY OF THE INTERIOR,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

REPLY BRIEF FOR PETITIONER

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REPLY BRIEF FOR PETITIONER

The Government does not dispute that a well-developed conflict involving multiple circuits exists over the question whether a federal agency that has given its regulation a definitive interpretation must engage in notice-and-comment rulemaking before reversing that interpretation. The author of the leading administrative law treatise recently urged that this Court resolve "this difference of opinion with respect to an important question . . . ." RICHARD J. PIERCE, JR., ADMINISTRATIVE LAW TREATISE § 6.4, at 131 (4th ed. Supp. 2009).

This case also directly presents the issue identified but left open for resolution in *Smiley v. Citibank (S.D.), N.A.*, 517 U.S. 735 (1996) -- whether a federal agency that changes its interpretation of its own regulation may give retroactive effect to the new interpretation.

The Government's efforts to play down the circuit conflict and to suggest that this case is not suitable for resolving these indisputably important issues are unavailing.

1. The Government contends that the several courts of appeals that have explicitly adopted petitioner's position regarding the need for notice and comment rulemaking might not have done so in light of this Court's decision in *FCC v. Fox Television Stations, Inc.*, 129 S. Ct. 1800 (2009), *see* Opp. 9. Yet the Government elsewhere acknowledges that

the salient *Fox Television* holding simply reiterates the rule established by this Court more than thirty years ago in *Vermont Yankee Nuclear Power Corp. v. NRDC*, 435 U.S. 519 (1978), *see* Opp. 7.

The Government's related contention that *Fox Television* should be read to have resolved the dispute adversely to petitioner, *see* Opp. 9, is belied by the fact that two of the four current members of this Court who have previously endorsed petitioner's position (*see* Pet. 15) joined the *Fox Television* majority, and two the dissent. The first question presented is very much a live issue.

Indeed, *Fox Television* explicitly endorsed a core principle undergirding the petition: that an agency bears special responsibilities when it has "engendered serious reliance interests." 129 S. Ct. at 1811 (noting that an agency must "provide a more detailed justification . . . when its prior policy has engendered serious reliance interests that must be taken into account"); *see also id.* at 1823 ("Reliance interests in the prior policy may also have weight in the analysis") (Kennedy, J., concurring); *id.* at 1826 (referencing the "substantial interest [of regulated entities] in regulatory stability") (Stevens, J., dissenting).

Here, the regulatory interpretation upon which petitioner relied was one which it and all similarly situated gas producers were explicitly instructed that they were *required* to follow, *see, e.g.*, Pet. App. 63a ("Dear Payor" letter stating that lessees "*must follow these guidelines*" (emphasis added). The

agency repeatedly and emphatically reiterated the mandatory nature of its instructions, *see* Pet. 6 (citing *id.* at 63a–68a). The concerns implicated here are thus precisely those raised in *Fox Television*.

2. The Government's position that the decision below is merely in "tension" but not in "conflict" with *Shell Offshore Inc. v. Babbitt*, 238 F.3d 622 (5th Cir. 2001), *see* Opp. 9, does not withstand scrutiny. The Fifth Circuit held that a five-year period of MMS practice, even though unaccompanied by any written guidance from the agency, was sufficiently authoritative to warrant notice-and-comment procedures, without suggesting any requirement of approval by an individual with authority to bind the agency. *Shell*, 238 F.3d at 628–29 ("[T]he new 'rule' that Shell asserts violates the APA is not a change from a written policy statement or regulation. Rather, it is an alteration of an existing practice.") The D.C. Circuit, by contrast, held that a seven-year period of MMS practice, even when combined with written, mandatory pronouncements by agency officials, did not demand notice-and-comment procedures. (Pet. App. 17a–20a). The conflict could not be starker.

3. The explicitly compulsory effect the agency choose to give its regulatory interpretation -- a feature wholly ignored in the Government's opposition -- makes this case a particularly appropriate vehicle for resolving whether an agency may simply reverse a regulatory interpretation without satisfying any APA procedural safeguards.

While petitioner's claim below was argued based upon the longstanding and mandatory nature of the agency's interpretation, petitioner may also support its claim by the additional argument that the author of the mandatory instruction had been delegated the authority to bind the agency with respect to royalty calculation issues. *See Yee v. City of Escondido*, 503 U.S. 519, 534 (1992) ("Once a federal claim is properly presented, a party can make any argument in support of that claim; parties are not limited to the precise arguments they made below.").[1]

"[T]he issue [of the existence and scope of the delegation of authority to an agency official] is purely a legal one," *Air Brake Sys., Inc. v. Mineta*, 357 F.3d 632, 646 (6th Cir. 2004), and the delegation here appears on the face of the agency promulgations, extending to the MMS Associate Director for Royalty Management "the ability to make the final, binding decision" on issues relating to "the Secretary's authority to . . . ensure[ ] that the Government is paid timely and in full for . . . its contractual royalty

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1 Thus, the plaintiff in *Lebron v. National Railroad Passenger Corp.*, 513 U.S. 374, 378-79 (1995), was allowed to base his claim (that Amtrak had violated the First Amendment) on the argument that Amtrak should be considered an instrumentality of the federal government, although he had in the court below disavowed that position and contended that Amtrak had violated the First Amendment as a private entity.

shares . . .," *see* Pet. 4 & nn.1-2. The Government's opposition does not dispute this delegation, which it did not bring to the attention of the court of appeals in this case or in *Amoco Production Co.* v. *Watson*, 410 F.3d 722 (D.C. Cir. 2005), *aff'd on other grounds sub. nom. BP America Production Co.* v. *Burton*, 549 U.S. 84 (2006).

4. While the Government suggests that this case is an inappropriate vehicle due to uncertainty whether petitioner would have been permitted to deduct its dehydration and compression costs under the agency's prior, mandatory instructions (Opp. 10), the Government fails to quote or even describe the actual language used by the agency in the "Dear Payor" letter:

> You can include costs of dehydration occurring after metering at the royalty measurement point in your transportation allowance but you cannot deduct costs of dehydration occurring at the wellhead. You can include costs for compression occurring downstream of the royalty measurement point, to the extent the compression is necessary for transportation. This includes compression at the CDP [central delivery point] and in the transportation system to the CO_2-removal facility. You cannot include those compression costs associated with production operations. (Pet. App. 66a).

There is no ambiguity here. The court of appeals certainly never held that petitioner could not deduct its compression and dehydration costs under the mandatory instructions. The theoretical possibility of such a holding on remand is extremely remote given the language quoted *supra*.[2]

5. The Government leaves almost untouched petitioner's arguments why review is also warranted to resolve whether a federal agency can retroactively impose additional financial obligations for the period prior to its new regulatory interpretation, when its contrary, mandatory instructions were still in force. Such conduct by the Government with respect to federal oil and gas leases goes to the heart of this Court's repeatedly-expressed concerns over the retroactive application of government requirements affecting "contractual [and] property rights [for] which predictability and stability are of prime

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[2] The notion that petitioner's having sought a determination of the propriety of its overall royalty obligation calculations itself suggests a lack of clarity in the mandatory instructions (Opp. 5) ignores that (a) the State of Wyoming was challenging petitioner's right to deduct *any* transportation costs incurred before the gas had been placed into marketable condition, *see, e.g.*, AR 87 (State averment that "a transportation allowance is not permitted for gas that is not in marketable condition"), and (b) the determination sought involved numerous unrelated issues including the valuation of gas sales, the treatment of transportation costs paid to related affiliates, and a request for an exception to certain reporting requirements, *see* C.A. App. 166-70.

importance." *Landgraf v. USI Film Prods.*, 511 U.S. 244, 271 (1994).

Recent decisions by this Court have reiterated these apprehensions regarding retroactivity. *E.g.*, *AT & T Corp. v. Hulteen*, 129 S. Ct. 1962, 1971 (2009) ("a presumption against retroactivity will generally coincide with legislative and public expectations. Requiring clear intent assures that Congress itself has affirmatively considered the potential unfairness of retroactive application and determined that it is an acceptable price to pay for the countervailing benefits" (quoting *Landgraf* 511 U.S. at 272-73); *Republic of Iraq v. Beaty*, 129 S. Ct. 2183, 2194 (2009) (noting "the judicial presumption against retroactivity").

6. Rather than addressing the importance of the retroactivity issue or the implications of *Landgraf* and the numerous other decisions cited by petitioner, the Government contends that "[p]etitioner did not challenge the retroactive impact of the agency's order in this case in its opening brief on appeal." (Opp. 11). This is simply not so.

The very first item listed under the heading "Statement of Issues Presented for Review" in petitioner's opening brief on appeal (at 2) was:

> Whether Interior can lawfully require Devon to recalculate its federal natural gas royalties *retroactively* using a new royalty valuation methodology that is inconsistent with . . . the methodology

> Devon and all other federal royalty payors were instructed to use at the time the royalty payments were made. (emphasis added).

Devon advanced this anti-retroactivity claim repeatedly in its opening and reply briefs:

> "Devon followed Interior's publicly-announced guidelines and instructions when it deducted its post-CDP dehydration and compression costs. Now, Interior says it can repudiate those guidelines and explicit instructions and require Devon to recalculate its royalties *retroactively* using Interior's new interpretation of its regulations. Interior is incorrect. Devon's reliance interest is protected by the APA." (Opening Br. 16) (emphasis added).

> "The decision is also arbitrary and capricious because . . . Devon has been required to comply with [the agency's new regulatory interpretation of marketable condition] *retroactively*." (Opening Br. 19) (emphasis added).

> "Devon has been required to *retroactively* recalculate its royalties using the new interpretation. . . ." (Opening Br. 47) (emphasis added).

> "Not only does Section 553 of the APA prohibit such a *retroactive* change in the agency's authoritatively-adopted valuation instructions, but this type of *retroactive* agency about-face is also arbitrary and capricious under Section 706 of the APA and Interior's own precedents." (Reply Brief 19 n.9) (emphasis added).

Petitioner thus explicitly and repeatedly advanced its retroactivity claim. To the extent the Government is merely contending that additional arguments in support of the retroactivity claim are set forth in the petition, again, that is clearly appropriate, *see* p. 4 *supra* and *Yee*, 503 U.S. at 534 ("Once a federal claim is properly presented, a party can make any argument in support of that claim; parties are not limited to the precise arguments they made below."); *see also PGA Tour, Inc. v. Martin*, 532 U.S. 661, 678 n.27 (2001).[3]

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[3] While the Government is of course entitled to audit a lessee's royalty payments and collect any underpayments relating to past production, *see* Opp. 11 n.2 (citing 30 U.S.C. §§ 1711(c)(1), 1724(d)(4)(B)(i)), these statutory provisions nowhere authorize Interior to give retroactive effect to a new interpretation of a lessee's royalty obligations. The "restructured accounting" referenced in § 1724(d)(4) is simply a required accounting of royalty obligations in order to correct for

(...continued)

7. Resolution of the issues presented is of substantial prospective importance, *cf.* Opp. 11. With respect to the specific governmental conduct at issue, the agency still has not engaged in the required notice and comment rulemaking, and the purported obligation of petitioner and other lessees to make retroactive payments covering the period before the Government changed its mandatory instructions is also still unresolved.

More generally, what procedural obligations are incumbent upon the Government before changing its regulatory interpretations is a recurring issue, and the disparate answers provided to date by the courts of appeals ensures that uncertainty and conflicting results will persist absent resolution by this Court.

Likewise, the "predictability and stability" that this Court has deemed of "prime importance"

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any "repeated, systemic reporting errors" in a lessee's original accounting, *see* § 1724(d)(4)(B)(i).

BP America Production Co. v. Burton, 549 U.S. 84 (2006), also cited at Opp. 11 n.2, addressed whether the six-year statute of limitations for government contract actions applies to administrative orders assessing royalty underpayments, a question having no bearing on any issue presented here.

(*Landgraf, supra*) will continue to be undercut absent clarification of the limitations against the establishment of retroactive obligations, particularly those which (as here) involve contractual and property rights.

CONCLUSION

The petition for a writ of certiorari should be granted.

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